Should You Have an "IRA-Stretch Trust?"

By Scott R. Severns

When planning your estate, retirement accounts deserve special attention. Many of our clients have more assets in tax-deferred accounts than they have in regular savings and investments. These accounts grow tax-free, so the growth accumulates more quickly. Over the long term, these savings can really mount up. These accounts can grow tax-free for your heirs, as well, if you plan carefully and follow IRS requirements strictly. An IRA-stretch trust may help.

> EXAMPLE:
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> John is 75 and widowed. He has $500,000 in IRAs, a house worth $250,000 and other investments worth $400,000. He has a daughter, age 42, who has a good income and his two grandsons, ages 14 and 12. He wants to leave some of his estate to his daughter, but he also wants to leave a legacy for his grandsons.
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> John's IRA continues to grow, even though he started taking Required Minimum Distributions (RMD's) at age 70 ½. He is proud of that account. He accumulated it over the course of 30 years. He wants to pass on the lessons of patience and long-term growth to his grandsons.
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> John can leave the IRA to his daughter and she will have the option to cash it out and pay the tax or continue the IRA and take required minimum distributions over her life expectancy. At her tax bracket, either option will cause substantial tax on the IRA withdrawals.
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> John decided on an IRA-stretch trust for his grandsons. This trust has special terms to assure that at John's death, the IRA can continue to be tax-deferred over the entire lifetimes of his grandsons. At their young ages, Required Minimum Distributions will be very small, so nearly all of the money can be left to grow tax-free.
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> His trust instructs the Trustee to manage the IRA funds for the grandsons while they are young. The Trustee is to give the grandsons only the small required minimum distributions each year, unless their needs or circumstances require more, for education, for instance. John chose to make his daughter the Trustee, and named a local bank as alternate Trustee.
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> When each of the grandsons arrives at a certain age, the Trustee's job will end and the grandson will take control of the inherited IRA directly. John chose each grandson's 35th birthday as the day for this transfer of responsibility to occur.

> He instructs his Trustee to pass along the story of how John patiently built up this account and took advantage of tax-deferred investing. This lesson - as well as what may well be a two or three-fold growth in the account by that time - is John’s legacy for his grandsons.

The advantages of tax-deferred accounts can be passed on to younger heirs. However, there are some landmines if the plan is not carefully designed. For instance, if John had named a charity, along with his grandsons as beneficiary in his IRA-trust, continued tax-deferral for the grandsons could be lost. It is important to consult with knowledgeable and experienced counsel when planning for the disposition of these special assets. Severns Associates is fully qualified to advise you in the best strategy for IRA-stretch trusts and other estate planning devices. To discuss your estate plans with one of our attorneys, please call our office to schedule an appointment.